

Service Date: December 6, 1989

DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

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IN THE MATTER Of The Application)	UTILITY DIVISION
Of MONTANA POWER COMPANY To Re-)	DOCKET NO. 87.8.38
structure Natural Gas Rates.)	
IN THE MATTER OF the Application)	
Of MONTANA POWER COMPANY For)	DOCKET NO. 87.3.16
Authority To Implement A Natural)	
Gas Incentive Rate.)	
IN THE MATTER Of The Application)	
Of MONTANA POWER COMPANY For)	DOCKET NO. 85.7.32
Authority To Implement An Experi-)	
mental Industrial Market Retention))	
Rate For Natural Gas.)	ORDER NO. 5410c

ORDER ON RECONSIDERATION

BACKGROUND

Final separate orders in MPC gas Docket No. 87.8.38 were issued on Cost Of Service (COS) and Rate Design (RD). On November 2, 1989 the Montana Public Service Commission (Commission) issued RD Order (No. 5410b) which addressed moderated Revenue Requirements, Rate Design and pricing. Stone Container (SC) filed a motion for reconsideration of Order No. 5410b.

Stone Container's Motion

To summarize, SC's motion requests the Commission to reconsider Findings of Facts (FOFs) in Order No. 5410b to develop a more reasoned and equitable approach to spreading and moderating the marginal COS study's revenue requirement responsibility for the Firm Utility (FU) and the Interruptible Industrial (II) customer classes. SC's motion further requests the Commission to clarify FOF 36 so that this finding is consistent with the Order No. 5410a compliance filing.

SC's motion requests the Commission to revise its Order No. 5410b decision which flowed through, on an equal percent basis, the residual decrease in revenues to the FU and II classes. Importantly, SC's motion accepted the Commission's moderated Revenue Requirement changes for the Residential and General Service classes. In lieu of the Commission's uniform percent decrease of roughly 6.52 percent in Table 4 of Order No. 5410b, SC proposes an increase in the FU Class' revenue requirement of .83 percent and a concomitant residual decrease of 12.98 percent to the II class.

SC's motion appears to contain five arguments in support of its proposed moderation of Revenue Requirements. SC's first principal argument holds the Commission's moderation of rate impacts and the roughly 6.52 percent decrease to the FU class reverses the objective of moving required Revenue Requirements toward "marginal cost-based rates" (SC Motion p. 4, last three lines). SC added that this first argument is sufficient basis for the Commission to revise its 6.52 percent decrease to the FU class in favor of SC's proposal (SC Motion, pp. 4 and 5).

Second, SC cites MCC's testimony which argues to assign more of any revenue reduction to those classes that have the widest differentials between allocated costs and present revenues (SC Motion, p. 2, fn. 2). Third, SC holds that the Commission flat price for the FU class is uneconomic and should change, in favor of rates that reflect the reconciled marginal cost of service from Order No. 5410a (SC Motion p. 5). SC's fourth argument holds that the absence of elasticity of demand studies is not reason to ignore the cost of service compliance filing (SC Motion, p. 5). Fifth, SC holds irrelevant the Commission's finding that as a result of flowing the residual revenue decrease through to the FU and II classes on an equal percent basis, the latter class gets a larger dollar share of the decrease (SC Motion, pp. 5 and 6).

As a point of clarification SC requested that certain percent change values appearing in Table 3 of Order No. 5410b be refined and reflect three additional decimal places of accuracy.

As a result, the percent changes for the General Service, II and FU would change as follows respectively: -4.55 to -4.64, -18.40 to -18.36 and 1.0 to .83 percent.

Commission's Decision on Motions

The Commission denies SC's motion to revise its Order No. 5410b moderation of Revenue Requirements. To summarize, the Commission's three main reasons for denying SC's motion are based on: 1) SC's misunderstanding of marginal cost versus reconciled marginal cost Revenue Requirements, 2) the Commission's finding of relevancy that the FU class' load is elastic, and 3) that whereas the II class has a failsafe tariff (the Industrial Market Retention tariff), no such failsafe tariff exists for the FU class. The following expands on these general reasons in the process of responding to each of SC's five arguments. Last the Commission will respond to SC's clarification request.

SC's first and admitted principal argument is that the Commission's order results in a "reversing" of the move of Revenue Requirements towards "marginal cost-based rates." This principal argument indicates SC is confused. SC's confusion, which leads it to submit an erroneous argument, appears due to a lack of understanding of the difference between "marginal cost" and "reconciled marginal cost" Revenue Requirements. There is a difference. Because of SC's confusion, it concluded incorrectly that the Commission's final revenue requirement for the FU class is a move away from a marginal cost-based revenue requirement. Such is not the case as evident from the following table:

Comparison of the Firm Utility Class'
Revenue Requirements
(000 of \$ rounded)

<u>Class</u>	<u>Existing Rev. Req.</u>	<u>Marginal Cost (MC) Rev. Req.</u>	<u>Reconciled MC Rev. Req.</u>	<u>Final Rev. Req.</u>
Firm Utility	16,345	15,300	16,480	15,300

Source: Taken from tables 1 through 4 of Order No. 5410b.

The above table indicates that SC's argument, that the Commission moved Revenue Requirements in the wrong direction for the FU class, is clearly in error. The FU's existing revenue requirement exceeds the marginal cost revenue requirement, and the Commission's final determined FU revenue requirement fell from the existing level to nearly the marginal cost level (rounding makes it look like the marginal cost and final Revenue Requirements are equal). Ironically, it is SC's proposal in its motion that would move the FU class' final revenue requirement away from a marginal cost-based revenue requirement.

SC's second argument draws upon MCC's testimony and regards spreading revenue requirement decreases based on differ-

entials between allocated costs and present revenues. The Commission found that in the absence of better elasticity of demand data a uniform percent decrease was appropriate. The relative elasticity of demand argument is one reason the Commission raised the residential class' revenue requirement above a marginal cost based level. Ignoring such general knowledge could result in the Commission simply applying the results of Table 3 in Order No. 5410a, i.e., simply using an equal percent reconciliation approach.

By so doing the FU class' revenue requirement would move away, not towards, its marginal cost revenue requirement. The result could be that MPC could lose the entire Great Falls Gas Company (GFG) load: This would be an uneconomic outcome.

Thus, moderating Revenue Requirements based on differentials is rather simplistic, which may explain why MCC qualified its remark as follows: "... and maybe the proper thing to do would be to assign more of the revenue reduction to the classes that had the wider differentials." (emphasis added) Further, such a method could have undesirable consequences, one of which is the loss of the GFG load, MPC's single largest load.

SC's third argument regards SC's comparison of seasonal costs and flat annual prices, and the conclusion that the

Commission tariffed "uneconomic rates." Unfortunately, some detail is required to clearly state and respond to SC's argument.

First, as background, in designing prices for the FU class the Commission held the class' revenue requirement constant at about 15.3 million dollars (Table 4 of Order No. 5410b). Next, the Commission posed the question whether it would be more efficient to tariff seasonal prices or a flat annual price. Either choice generates the same level of annual revenues. As it turned out, the efficiency argument for tariffing seasonal prices was strongest for the FU class. If the Commission tariffed marginal cost based seasonal prices, the FU winter and summer prices would roughly equal \$3.47 and 2.78/Mcf respectively. However, the Commission decided to tariff a flat annual rate of \$3.246/Mcf. Such a decision results in a single price that is, to some extent, uneconomic year round. Importantly, SC supported the 7 percent increase in the Residential class' revenue requirement, which similarly generates uneconomic prices relative to strict marginal cost based prices.

Second, in this argument SC explicitly proposes that the Commission charge the FU class its "reconciled marginal cost of service" revenue requirement. This is another indicator that SC is confused on the difference between "marginal cost" and "reconciled

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marginal cost" Revenue Requirements. On one hand, SC stated there is still time to correct the FU's uneconomic rate. On the other hand, SC proposed the Commission use the "reconciled marginal cost" revenue requirement. The two proposals are mutually inconsistent as the Commission noted earlier: If the Commission corrected the FU's "uneconomic rate," the Commission would in fact lower the FU class' revenue requirement to get exactly to a marginal cost level, not a reconciled marginal cost level. That is, the seasonal cost figures cited above and in Order No. 5410b derive from MPC's compliance marginal cost study, not the reconciled marginal cost revenue requirement. There is a difference.

As an aside, the Commission was surprised with but finds laudable SC's emerging concern for efficient prices, and in particular economic seasonal prices. Marginal cost based economic seasonal prices were not supported in SC's testimony in this docket (see Finding of Fact No. 10, Order No. 5410a). Whereas the Commission found merit in deferring the implementation of seasonal prices in this docket, the likelihood of seasonal prices out of MPC's upcoming gas transportation docket is greatly enhanced with SC's support.

SC's fourth and fifth arguments regard Finding of Fact No. 40 in Order No. 5410b. Contrary to SC's opinion the Commission

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does find that elasticity of demand knowledge is relevant in setting overall class Revenue Requirements as well as intra-class prices. Why does SC believe the Commission raised the Residential class' revenue requirement above that justified by MPC's compliance COS study while at the same time moving the II class' revenue requirement towards the marginal costs from the same compliance COS study? One reason is the Commission's belief that the II class' demand is more elastic, on average, than the residential class' demand. Moreover, why does SC believe the Commission allows MPC to charge II customers prices via the Industrial Market Retention (IMR) tariff? Again, one reason is the II class' demand is relatively elastic. Similarly, it is quite clear, at least to the Commission, that GFG is a potential bypass candidate that has no IMR option. If SC doubts this belief, it should invalidate GFG's bypass claim which the Commission anticipates in the upcoming MPC transportation docket.

SC's fifth and last argument points out the obvious, that the reason the II class got the larger dollar decrease is because its overall revenue requirement was larger to start with. The Commission finds nothing to disagree with in this statement. Nevertheless, this statement is not, by any means, a convincing basis on which to revise the Order No. 5410b decision. However, in

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the paragraph immediately following this argument SC once again
reveals its confusion on "marginal cost" and "reconciled marginal
cost" Revenue Requirements. SC states, in part: "...and implement
a marginal cost of service based rate increase of 0.83 percent for
the FU class...".

The Commission, once again, cannot ignore this misleading
proposal. As stated in Table 1 of Order No. 5410b, a marginal cost
revenue requirement for the FU class would result in a 7 percent
decrease to the "current revenues" in the same table, not a .83
percent increase. The FU class would get a ".83 percent" (1.0
percent from Table 3 of Order No. 5410b) increase only if the
Commission set this class' revenue requirement based on explicitly
stated "reconciled revenues." Reconciled Revenue Requirements do
not equal "marginal cost of service" Revenue Requirements.

Finally, the Commission will respond to SC's motion for
clarification. The Commission accepts SC's data which refines the
deliberately rounded data in Table 3. The Commission's order
likewise rounded all cost data in all other Order No. 5410b Tables,
which could be similarly refined, but to no purpose.

CONCLUSIONS OF LAW

1. The Applicant, Montana Power Company, furnishes natural gas service to consumers in Montana, and is a "public utility" under the regulatory jurisdiction of the Montana Public Service Commission. § 69-3-101, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over Montana Power Company's rates and operations. § 69-3-102, MCA, and Title 69, Chapter 3, Part 3, MCA.

3. The Montana Public Service Commission has provided adequate public notice of all proceedings, and an opportunity to be heard to all interested parties in this Docket. § 69-3-303, MCA, § 69-3-104, MCA, and Title 2, Chapter 4, MCA.

ORDER

Stone Container's Motion for Reconsideration of Order No. 5410b is hereby denied. Stone Container's request for clarification is granted. (See Paragraph 19.)

DONE AND DATED At Helena, Montana this 27th day of November, 1989 by a 5-0 vote.

BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION

CLYDE JARVIS, Chairman

HOWARD L. ELLIS, Vice Chairman

JOHN B. DRISCOLL, Commissioner

WALLACE W. "WALLY" MERCER, Commissioner

DANNY OBERG, Commissioner

ATTEST:

Ann Peck
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review in this matter. Judicial review may be obtained by filing a petition for review within thirty (30) days of the service of this order. Section 2-4-702, MCA.